Ideology, Interests, and Institutions

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Profound commitments to policies are generally due to a mix of ideological factors (in the form of ideas and example), interests (as defined by politics and economics), and institutions (as they shape constraints and opportunities).

Few economists have seriously doubted the significance of the influence of ideas on policy since Keynes wrote: "The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist." (1936, p. 383) Those who continue to doubt this ought to heed the greater eloquence of Thomas Carlyle. His loquacity at a dinner led a companion to reproach him: "Ideas, Mr. Carlyle, ideas, nothing but ideas!" Carlyle retorted: "There was once a man called Rousseau who wrote a book containing nothing but ideas. The second edition was bound in the skins of those who laughed at the first." (See MacIntyre 1985.)

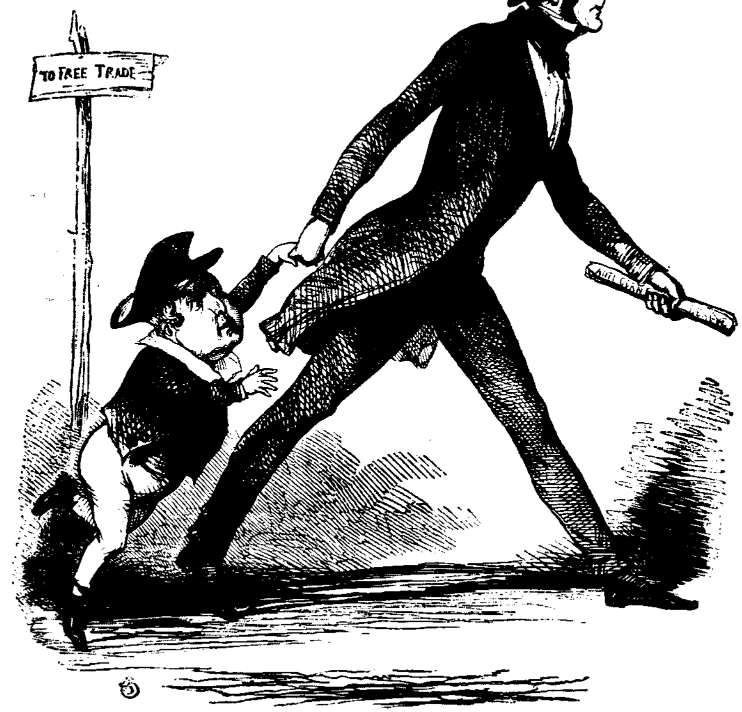
But ideas play on a stage where interests are no less in evidence. It would be vulgar to claim that interests dominate exclusively, the appropriate ideology being chosen simply to legitimate the triumphant interests. However, John Stuart Mill surely had it right when he observed that "a good cause seldom triumphs unless someone's interest is bound up in it."[1]

This interplay of interests and ideology is nowhere more evident than in the episode of the repeal of the Corn Laws, which occurred in 1846 and which ushered in Britain's nineteenth-century embrace of free trade. This historic transition was neither exclusively the result of interests nor entirely the product of a powerful ideology.

Although Richard Cobden's rhetoric and his vision were inspired by faith in the economic and political merits of free trade for Britain, and indeed for the trading world at large, his Anti–Corn Law League drew much of its support from the fact that cheap corn imports were seen as profitable for consumers and for industry. This created ample "sectional-interest," pressure-group support for Cobden's "social-interest"-inspired movement. In the end, however, the repeal of the Corn Laws turned on Prime Minister Robert Peel's cerebral conversion to the idea of free trade, which led him to abandon the sectional protectionist interests of his Conservative Party. Indeed, charged by his foe Disraeli with having betrayed his party for the principles of political economy, Peel found his political career destroyed beyond repair.[2]

1. Quoted in Kindleberger's (1982–83) insightful examination of historical cycles in protection and free trade.

2. Sarah Bradford, in her biography of Disraeli, observes: "To [the Conservatives] Peel, in twice reversing his position on two great issues of the day, Catholic Emancipation and the Corn Laws, was guilty of betraying his party and the principles upon which he had come to power. It was this view, which concerned not economics but party principle, that Disraeli hammered home so successfully, and it was this same general feeling among parliamentarians of both sides that was primarily responsible for Peel's fall" (1984, p. 159). She cites a contemporary's telling remark: "[Peel] cared a great deal, he saw so much clearly, and yet at some points he was shut in by political economy as if by a fog."



PAPA COBDEN TAKING MASTER ROBERT A FREE TRADE WALK.

PAPA COBDEN.—"Come along, MASTER ROBERT, do step out."
MASTER ROBERT.—"That's all very well, but you know I cannot go so fast as you do."

This 1845 cartoon from *Punch* shows Cobden leading Peel toward free trade, underlining Cobden's advocacy and Peel's later conversion.

Peel was "persuaded, not purchased; baptised, not bought."[3]

The remarkable role played by Peel also illustrates well the opportunity provided by the parliamentary structure of British politics and the relatively elitist nature of the politics of the time. These factors facilitated an ideologically converted prime minister's ability to get around the special interests within his party.

Similarly, the postwar liberalization of trade can be explained in terms of forces that span ideas and example, interests and institutions.

Example

The architects of the liberal postwar order and the ensuing trade liberalization were not merely intellectual believers in the virtues of freer trade. They were also the beneficiaries of a splendid historical example: an experience with tariffs that was widely perceived to have been a spectacular failure.

The Great Depression had been associated with beggar-my-neighbor policies of competitive exchange-rate depreciation and tariff escalation, each aimed at preserving and deflecting aggregate demand toward one's own industries at the expense of those of one's trading partners.[4] Few believe that such policies caused the Depression; there are many more plausible candidates for the role of villain.[5] But it is certainly arguable that the tariff escalations deepened the Depression.[6]

Representative Willis Hawley (R, Oregon) and Senator Reed Smoot (R, Utah) at the U.S. Capitol, April 11, 1929.

3. Bhagwati and Irwin 1987, p. 130. Peel's own papers record his change of opinion on this issue of free trade. Parker (1899, p. 220) writes: "[Peel] had removed prohibitory duties on foreign cattle and meat, and had lowered duties on sugar and on other articles of food. . . . Of himself Sir Robert Peel writes, 'The opinions I had previously entertained had undergone a great change.' " Peel is also on record as saying: "I will not withhold the damage which is due to the progress of reason and to truth, by denying that my opinions on the subject of protection have undergone a change" (Gash 1972, p. 567).

4. The Smoot-Hawley tariff of 1930 in the U.S., which I discuss below, was characterized by some new duties that could not be explained by conventional protective reasons but were evidently aimed at diverting demand away from foreign goods. Mann (1987) cites Isaacs' (1948) study on this question, including the example of a 1000% increase in the tariff on cashew nuts (not produced in the U.S. then). The fact that the U.S. was also running a balance-of-payments surplus at the time made these duties particularly irksome as evidence of beggar-my-neighbor policies unworthy of a creditor nation. Mann quotes Liepmann (1938): "Nothing has contributed more to the impeding of international trade relations than the American tariff of 1930, by which the greatest creditor nation in the world surrounded itself at the moment of severe crises with the highest tariff walls in its history."

5. See, for instance, the rival explanations of Friedman and Schwartz (1963), Kindleberger (1986), and Temin (1976).

6. However, as Eichengreen (1986) has suggested, the evidence can be analyzed as indicating (mildly) otherwise for the U.S. in the case of the Smoot-Hawley tariff.

In any event, the *perception* grew and persisted that the Smoot-Hawley tariff-raising binge, in which virtually every industry was rewarded with its own "made-to-order" tariff[7] (with the apparent consequence of foreign tariff retaliations[8] and a worsening depression), was a disaster.

As John Kenneth Galbraith has wittily said of an economist foe, his misfortune has been that his theories have been applied: blooming in the ivory tower, they have wilted in the real world. For the proponents of free trade, the magnitude of the failure of tariffs, and indeed of their seemingly counterproductive results, during the Depression was a real dividend. It helped to stack the cards in favor of the pro-trade forces, providing the ideological momentum for liberal trade that persists to this date.[9]

Whereas this pro-trade bias was shared by all the countries that the Depression afflicted, its principal convert was the United States.[10] This would be critical, as the United States was steadily emerging as a major force and the Second World War would leave it as the dominant power shaping the world economy. The immediate result, even before the war, was a dramatic (indeed drastic) shift in trade policy by a chastened group of American policymakers.

7. Schattschneider's (1935) account of the enactment of the Smoot-Hawley tariff is one of the great turning points in the theory of political economy. Incidentally, the tariff should have been called Hawley-Smoot, since a bill is customarily named after its first proposer in the process and since a tariff (being a revenue bill) has to originate in the House and then go to the Senate. But fame, like infamy, evidently does not play by protocol.

8. Eichengreen (1986) cites some tentative evidence that the tariffs enacted later by Canada and some European countries were due to the Depression and might have arisen even if there had been no Smoot-Hawley tariff to retaliate against.

9. Goldstein (1986) has used the phrase "liberal bias" to describe this ideological shift.

10. This was natural. After all, the U.S.-legislated Smoot-Hawley tariff had been the most visible and dramatic act of anti-trade folly.

The institutional structure that had facilitated the enactment of the Smoot-Hawley tariff was modified. Stung by its own failure and by a severe electoral judgment, the Congress—which had given in to each sectional interest's demand for tariff protection—acquiesced in a classic shift of power in trade-policy initiatives and management to the executive branch, which was less amenable to constituency pressure. This was coupled with an active, negotiated dismantling of the post-depression tariff walls under the 1934 Reciprocal Trade Agreements Act by an executive branch that was not only freer from protectionist constituency pressures (directly and indirectly via the Congress) but also eager to indulge the newly acquired pro-trade bias.[11] The pro-trade bias would also underlie the institutional design of GATT at the end of the war.[12]

Ideas

The pro-trade bias, strengthened by the interwar experience of competitive and retaliatory tariff-making, lay comfortably within the intellectual tradition of free trade that had existed

11. There is an important dispute among the students of U.S. trade policy as to whether the pro-trade bias was only in the executive branch or also extended to Congress in the postwar period. The conventional view, stated by Pastor (1983) and shared by many political scientists, is that Congress was to become equally infected by this pro-trade bias and indulged in constituency-directed protectionist noises while getting the executive branch to nip actual protectionism in the bud. This "cry-and-sigh syndrome" thesis has been challenged by Nelson (1987), who argues that Congress has continued to reflect constituency pressures but that its ability to deliver protection has been reduced by the institutional shift toward administered protection and by the pro-trade bias of the executive branch.

12. GATT was not the original institution designed at the Bretton Woods Conference in 1944. Rather, the International Trade Organization had been proposed, along with the IMF and the World Bank. However, the ITO was not ratified, and GATT—intended only to be a transitional agreement—became the *de facto* institution overseeing trade in the postwar period.

since the time of Adam Smith. But it is critical to understand just how.

The Intellectual Case for Unilateral Free Trade

The theory of commercial policy, as it evolved from David Ricardo and John Stuart Mill through the writings of Alfred Marshall and Francis Edgeworth at the turn of the nineteenth century, strongly implied that a nation would profit most by pursuing a free trade policy and that this was so whether its trading partners were free-traders or protectionists. *Unilateral* free trade emerged as the prescription from this corpus of thought.

The Theory

Central to this theory was the notion that—given external trading opportunities—specialization and the ensuing exchange would ensure gains from trade among nations engaged in voluntary transactions. It is easy enough to see this today, but when the early economists propagated this notion it was in contradiction to the dominant doctrine of mercantilism. The virtues of division of labor and exchange, noted even in Plato's *Republic*,[13] had been lost to oblivion. Mercantilism and its legitimation of autarkic protective policies seemed to be only common sense, reminding one that common sense is what makes a person assert that the earth is flat, for that is how it appears to the naked eye.

The new science of political economy focused on trade as an opportunity to specialize in production, to exchange what one produced efficiently for what others produced efficiently, and thus to wind up with more rather than less. A policy of free trade would guide a nation to an efficient utilization of this trade opportunity. In essence, as postwar theorists of international trade would clarify, free trade would maximize returns by efficiently utilizing two alternative ways of securing any good: through specialized production of other goods, to be exchanged in trade for the desired good, and through domestic production of the desired good. Free trade would ensure that these two alternative techniques—trade and domestic production—would be used efficiently (that is, in such a mix as to produce equal returns at the margin). (For a formal statement of these theoretical principles, see chapter 17 of Bhagwati and Srinivasan 1983.)

Two critical assumptions underlay this neat conclusion, and the classical economists were cognizant of them in their own way.

The first was that free trade would guide one to the efficient outcome only if the price mechanism worked well. Prices had to reflect true social costs. John Stuart Mill was smart enough to warn that the protection of infant industries could be justified. In modern language: If there were future returns that could not be captured by an infant industry but would dissipate to others in the country, this market failure justified protection.

Equally, if a country's trade in a sector was large enough to confer on it the ability to affect prices, then a tariff could enable the country to restrict its trade and gain more (just as a monopolist can increase profits by restricting his sales). Hence, this came to be known as the *monopoly-power-in-trade* argument for protection.

The second assumption was that a country's external trade opportunity had to be independent of its own trade policy. Suppose that, by imposing tariffs, you could pry open the protected markets of your trading partners. That could conceivably justify the use of tariffs, in which case unilateral

13. I stumbled on Plato's remarkable statement of the advantages of specialization, found that it was indeed a lost treasure, and had George Stigler (the Nobel laureate and distinguished connoisseur of intellectual history in economics) publish it on the back cover of the *Journal of Political Economy* in 1985.

free trade would not be desirable. Even Adam Smith was aware of this possible qualification; indeed, he considered the question at some length:

> *The case in which it may sometimes be a matter of deliberation how far it is proper to continue the free importation of certain foreign goods, is, when some foreign nation restrains by high duties or prohibitions the importation of some of our manufactures into their country. Revenge in this case naturally dictates retaliation, and that we should impose the like duties and prohibitions upon the importation of some or all of their manufactures into ours. Nations accordingly seldom fail to retaliate in the manner.*
>
> *There may be good policy in retaliations of this kind, when there is a probability that they will procure the repeal of the high duties or prohibitions complained of. The recovery of a great foreign market will generally more than compensate the transitory inconveniencey of paying dearer during a short time for some sorts of goods. To judge whether such retaliations are likely to produce such an effect, does not, perhaps, belong so much to the science of a legislator, whose deliberations ought to be governed by general principles which are always the same, as to the skill of that insidious and crafty animal, vulgarly called a stateman or politician, whose councils are directed by the momentary fluctuations of affairs. When there is no probability that any such repeal can be procured, it seems a bad method of compensating the injury done to certain classes of our people, to do another injury ourselves, not only to those classes, but to almost all the other classes of them. (1776, pp. 434–435)*

Smith's skepticism toward retaliatory protection was later to be shared by the great British economist Alfred Marshall and by others who recognized its theoretical possibility but nonetheless advocated unilateral free trade in practice.

Empirical Judgment and the Nineteenth-Century British Debate

In the end, the intellectual case for free trade and the case for free trade as a unilateral policy had to rest on the empirical judgment that the exceptions were unimportant or were merely theoretical *curiosa*, and that, even if this were not so, protectionist policies based on them were likely to cause more harm than good.

This is evident from the remarkable debate that ensued at the end of the nineteenth century when Britain, in relative decline as Germany and the United States rose in economic stature, found its long-standing policy of unilateral free trade in serious jeopardy from the "reciprocitarians," who wanted Britain to match the tariffs of other countries with tariffs of her own. British statesmen and economists who were wedded to unilateralism marshaled the following arguments against the reciprocitarians[14]:

- The belief in the folly of protection was so complete that it was felt that grievous losses to be suffered by its practitioners would suffice to induce them to embrace free trade. The *Times* editorialized in 1881 that "protection, as we well know, brings its own punishment. We are safe, therefore, in leaving its adherents to the stern teaching of facts. Nature will retaliate upon France whether we do so or not."
- Others believed that the success of a free-trading Britain would make her an example for other nations. In 1846 Robert Peel had argued in Parliament, in defense of a unilateral free-trade policy, that

> *If other countries choose to buy in the dearest market, such an option on their part constitutes no reason why we should not be permitted to buy in the cheapest. I trust the Government . . . will not resume the policy which they and we have found most inconvenient, namely, the haggling with foreign countries about reciprocal concessions, instead of taking that independent course which we believe to be conducive to our own interests. Let us trust to the influence of public*

14. For a more extensive discussion see Bhagwati and Irwin 1987.

THE BRITISH LION IN 1850;

OR, THE EFFECTS OF FREE TRADE.

This 1846 cartoon from *Punch*, showing the British lion in plenitude and prosperity after the repeal of the Corn Laws, illustrates the supreme confidence that the supporters of free trade had in its virtues.

opinion in other countries—let us trust that our example, with the proof of practical benefits we derive from it, will at no remote period insure the adoption of the principles on which we have acted.

• Richard Cobden, the great crusader for the repeal of the Corn Laws and the adoption of free trade, went so far as to argue that insisting on reciprocal tariff reductions would only make the task of free-traders abroad more difficult by implying that free trade was really in Britain's interest rather than their own. Thus, the Anti–Corn Law League emphasized Britain's potential gain from a free trade policy but "expressly refrained from appealing to any foreign sentiment in favour of the [free trade] cause [, for] they rightly judged that such appeals were certain to be misrepresented by the interests which stood behind protective tariffs and would play into the hands of their enemies" (Hobson 1919, p. 40). As Cobden put it,

We came to the conclusion that the less we attempted to persuade foreigners to adopt our trade principles, the better; for we discovered so much suspicion of the motives of England, that it was lending an argument to the protectionists abroad to incite the popular feeling against free-traders, by enabling them to say, "See what these men are wanting to do; they are partisans of England and they are seeking to prostitute our industries at the feet of that perfidious nation. . . ." To take away this pretense, we avowed our total indifference whether other nations became free-traders or not; but we should abolish Protection for our own selves, and leave other countries to take whatever course they liked best.[15] *(quoted in Hobson 1919, p. 41)*

15. That many thought Britain would gain from unilateral free trade does not, of course, imply that it actually gained from such a policy. McCloskey (1980) has argued that free trade harmed Britain through worsened terms of trade—i.e., that an optimal tariff was necessary. However, McCloskey's analysis was entirely based on intuition, whereas Irwin (1987) has estimated British foreign trade elasticities for that period and calculated the welfare

• Many felt that reciprocity was not an effective instrument for securing tariff reductions abroad because they felt that Britain lacked the necessary economic power. Alfred Marshall suggested that England was "not in a strong position for reprisals against hostile tariffs, because there are no important exports of hers, which other countries need so urgently as to be willing to take them from her at considerably increased cost; and because none of her rivals would permanently suffer serious injury through the partial exclusion of any products of theirs with which England can afford to dispense" (quoted in Keynes 1926, p. 408).

• In addition, some feared that Britain was more vulnerable to retaliation than other countries. In 1881 William Gladstone asked, in the *Times*,

Can you strike the foreigners hard by retaliatory tariffs? What manufactures do you import from abroad? In all £45 million. What manufactures do you export? Nearer £200 million. . . . If you are to make the foreigner feel, you must make him feel by striking him in his largest industrial interests; but the interests which he has in sending manufactures to you is one of his smallest interests, and you are invited to inflict wounds upon yourself in the field measured by £45 million, while he has got exactly the same power of inflicting wounds upon you on a field measured by more than £200 million.

• Marshall even suggested that infant-industry protection justified some of the foreign tariffs of Britain's new rivals, so that reciprocity was inappropriate. He wrote that "it would have been foolish for nations with immature industries to adopt England's [free trade] system pure and simple" (Keynes 1926, p. 392).

• Several economists of the time were convinced that, however sound the rationale underlying the use of tariffs for reciprocity, the policy would wind up being captured by protectionists and political interests. Marshall, after observing the American experience with protection (which reinforced his skepticism toward rational tariff intervention), felt that "in becoming intricate [protection] became corrupt, and tended to corrupt general politics" (Keynes 1926, p. 394). Marshall was not alone in this view. A 1903 manifesto signed by a number of distinguished British economists (including Francis Edgeworth, Arthur Bowley, and Edwin Cannan) and published in the *Times* warned that "protection brings in its train, the loss of purity in politics, the unfair advantage given to those who wield the powers of jobbery and corruption, unjust distribution of wealth, and the growth of sinister interests." This was undoubtedly an early manifestation of the recent developments in the theory of political economy and international trade that replaced the orthodox view that governments are benign and omnipotent with the view that their policies may reflect lobbying by pressure groups (which lobbying may lead to defects in the visible hand that outweigh ones in the invisible hand for which remedy is sought).

These arguments proved compelling at the time in Britain. But unilateralism in free trade has found little echo in other periods, including that of postwar trade liberalization. For the intellectual mainsprings for symmetric or mutual free trade (and trade liberalization), one must turn to other arguments (which I shall develop shortly).

loss of unilateral tariff reduction at about 0.5 percent of national income in the very short run. As Irwin points out, though, longer-run elasticities imply an extremely small welfare loss, and if foreign tariff reductions are factored in (resulting from Britain's demonstration effect promoting free trade) Irwin finds that Britain was made better off. In terms of optimal policy, Irwin suggests, Britain may have timed things well by imposing trade restrictions in the 1820s and 1830s, when her monopoly power in trade was strong, and instituting gradual trade liberalization in the 1840s and thereafter as her hold on world markets was eroding.

Postwar Theoretical Developments

It should be noted immediately that the intellectual case for free trade as a policy for maximizing national advantage, as explained above, benefited greatly from the postwar developments in the theory of commercial policy that showed that the traditional case for protection for *domestic* market failure (such as that involved in the case of infant-industry protection) was weaker than had been thought. An appropriate tariff could improve welfare over free trade; however, a more appropriate policy intervention was a domestic one, targeted directly at the source of the market failure. In jargon: The first-best policy intervention in the case of domestic distortions (or market failure) was domestic; the tariff would be a second-best policy. Tariffs were appropriate only when there was a foreign distortion (or market failure); they were the first-best policy only when there was monopoly power in external markets. Tariffs were thus demoted to a more limited role than in earlier theorizing.[16]

But even this monopoly-power-in-trade argument was called into question. It required the presence of non-negligible market power in international markets; surely its application was limited to cases (such as jute and oil) where market shares were significant and entry was difficult. More serious, the use of tariffs to exploit monopoly power opened up the distinct possibility of retaliation—a possibility that had only been underscored by the interwar experience and the apparent reaction to the Smoot-Hawley tariff. Early theorists conjectured that though a country might reap a short-run advantage by using a tariff to exploit its market power, retaliation would leave all countries worse off. Later analysis, however, showed that an ultimate net gain, despite retaliation, could indeed be possible.[17] Although retaliation could not be demonstrated to rule out a final gain to a country adopting a tariff to exploit its monopoly power in trade, that it could immiserize such a country (and others) was analytically established, calling in doubt the wisdom of even this time-honored exception to the argument that a free trade policy would maximize a nation's welfare.

16. The postwar developments in the theory of commercial policy have been the work of many theorists (including Harry Johnson, T. N. Srinivasan, and Max Corden), but they originated independently with Bhagwati and Ramaswami (1963) and Meade (1951). For a statement of the theory, see Johnson 1965; for a synthesis and a generalization, consult Bhagwati 1971.

Free Trade for One versus Free Trade for All

Because the economic theory of free trade was focused on free trade for one country rather than on free trade for all, it offers no direct guidance for the design of an international trading system or regime. Are there any indications in this body of economic thought as to what rules might be sought for the governing of trade among nations? This is certainly the kind of question that confronted the framers of GATT.

Now, there is indeed a *cosmopolitan* (as opposed to the nationalist) version of the theory of free trade. If one applies the logic of efficiency to the allocation of activity among all trading nations, and not merely within one's own nation-state, it is easy enough to see that it yields the prescription of free trade everywhere—that alone would ensure that goods and services would be produced where it could be done most cheaply. The notion that prices reflect true social costs is crucial to this conclusion, just as it is to the case for free trade for one nation alone. If any nation uses tariffs or subsidies

17. Scitovsky (1941) conjectured the immiserization of all. Using a Cournot-Nash tariff-retaliation model, Johnson (1953) demonstrated the possibility of a final net gain nonetheless. Rodriguez (1974) showed that the Johnson analysis, with quotas substituting for tariffs, would restore Scitovsky's conjecture. For an excellent review of this literature, see McMillan 1986.

(protection or promotion) to drive a wedge between market prices and social costs rather than to close a gap arising from market failure, then surely that is not consonant with an efficient world allocation of activity. The rule then emerges that free trade must apply to all.

Therefore, where the nationalist theory of free trade glosses over the use of tariffs, quotas, and subsidies by other countries, urging free trade for a nation regardless of what others do, the cosmopolitan theory requires adherence to free trade everywhere. The trade regime that one constructs must then rule out artificial comparative advantage arising from interventions such as subsidies and protection. It must equally frown upon dumping, insofar as it is a technique used successfully to secure an otherwise untenable foothold in world markets.

The two theories of free trade therefore stand in somewhat striking contrast to one another in terms of what they imply about unilateral and universal free trade.

Darwinism and "Fairness"

The unilateralist prescription runs into the further problem that it is at variance with the intuitive, Darwinian rationale for free trade. Think of the issue not in terms of other countries' using protection while one's own country maintains free trade (the question that nineteenth-century Britain debated, which is of equal concern to the United States today), but in terms of other countries' using export subsidies while one's own country keeps its markets open. Now, it is hard enough to cope with the demise of an industry in pursuit of the gains from trade if another country has a market-determined advantage. But if the foreign industry is backed by artificial support from its government, that often raises angry questions of "fairness."

An economist is right to claim that, if foreign governments subsidize their exports, this is simply marvelous for his own country, which then gets cheaper goods and thus should unilaterally maintain a policy of free trade. He must, however, recognize that the acceptance of this position will fuel demands for protection and imperil the possibility of maintaining the legitimacy, and hence the continuation, of free trade. A free trade regime that does not rein in or seek to regulate artificial subventions will likely help trigger its own demise. An analogy that I used to illustrate this "systemic" implication of the unilateralist position in conversing with Milton Friedman on his celebrated *Free to Choose* television series is perhaps apt: Would one be wise to receive stolen property simply because it is cheaper, or would one rather vote to prohibit such transactions because of their systemic consequences?

This line of thought supports the cosmopolitan economist's position that the world trading order ought to reflect the essence of the principle of free trade for all—for example, by permitting the appropriate use of countervailing duties and anti-dumping actions to maintain fair, competitive trade.

GATT and Reciprocity

Indeed, that is precisely the conception that underlies GATT. Influenced by these theoretical economic considerations and by the practical political constraints on the shape of an international trade regime, GATT amounts to what I like to call a *contractarian* institution. Its underlying essence is a concept of symmetric rights and obligations for member states, rather than unilateralism in free trade.

In this sense GATT also—broadly—reflects the notion of *full* reciprocity (i.e., a broad balance of market-access obligations by the contracting parties).[18] However (in keeping with the century-old practice of most nations in reciprocal bargaining with tariff reduction, as embodied in the 1934 RTAA legislation and subsequent practice of the United States), it also incorporates the related but distinct principle of what I have called *first-difference reciprocity*—that is, tariff cuts are to proceed via bargaining that reflects a balance of perceived advantages at the margin rather than via negotiations that result in a perceived full equality of market access and reverse market access (or what, in modern American parlance, is pithily described as a "level playing field").

But this contrast between GATT's broadly contractarian, full-reciprocity goals and conception and its procedural practice of first-difference reciprocity in negotiations has built into it the possibility of tension if any major contracting party wishes to rewrite the history of accession by members to GATT and reopen the question of balance in overall market access.[19] The U.S. Congress has recently been pressing for precisely this and even more,[20] with unavoidable and unfortunate consequences favorable to the politics of protection.

Interests

Let us return to the theme of the interests that also shaped the postwar liberalization. Here, the interests as they obtained in the United States are evidently of central importance. These interests unambiguously reinforced the ideas favoring freer trade.

Structuralist political scientists have argued that dominant nations seek access to world markets, seeing in liberal trade policies and regimes their own national interest. (See Krasner 1976 and Keohane 1980.) This argument has been prompted by the fact that trade liberalization, albeit of different varieties, followed both nineteenth-century Britain's and twentieth-century America's rise to economic power. But national power in itself does not lead to liberal trade regimes; the USSR's hegemony led only to exploitation of its satellites, substituting what economists call "unrequited transfers" for "gains from trade" (Ruggie 1982). The structuralist argument requires, therefore, an added element: that the hegemonic power be capitalist.

But if the national interest of a powerful capitalist economy leads to a liberal trading regime, this national interest shades into domestic interests as constituted by the "animal spirits" of capitalists seeking outward reach, aspiring to ex-

18. The emphasis on reciprocity of obligations was also reinforced by the interwar experience with unilateral, self-serving but mutually destructive tariff-making and competitive exchange-rate depreciations. Nowhere is this notion better conveyed than in Robinson 1947:

The popular view that free trade is all very well so long as all nations are free-traders, but that when other nations erect tariffs we must erect tariffs too, is countered by the argument that it would be just as sensible to drop rocks into our harbors because other nations have rocky coasts. This argument, once more, is unexceptionable on its own ground. The tariffs of foreign nations (except in so far as they can be modified by bargaining) are simply a fact of nature from the point of view of the home authorities, and the maximum of specialization that is possible in face of them still yields the maximum of efficiency. But when the game of beggar-my-neighbor has been played for one or two rounds, and foreign nations have stimulated their exports and cut down their imports by every device in their power, the burden of unemployment upon any country which refuses to join in the game will become intolerable and the demand for some form of retaliation irresistible. The popular view that tariffs must be answered by tariffs has therefore much practical force, though the question still remains open from which suit in any given circumstances it is wisest to play a card. (p. 192)

19. The terms of accession by contracting parties to GATT are, in principle, supposed to equalize broadly the balance of overall access, in my judgment.

20. E.g., balance of mutual access is sought even at intra-sectoral levels.

ploit other countries' markets. Further, a country's ability to defy sectional interests and open its markets is likely to be enhanced by the country's rise to economic power. Power reflects prosperity, and prosperity makes the embrace of anti-protectionism easier. Indeed, there is systematic evidence (see chapter 3) to support the hypothesis that bad macroeconomics goes with bad news for freer trade: the protectionist pressures increase significantly with economic distress.

But there is a subtler issue here, reflecting back on the perception of national interest. It is one of psychology, rooted in the Darwinian conception of free trade that I sketched above. It is often argued that, in politics, free trade comes as one's ideological and policy preference only when one is strong. The Darwinian doctrine appeals to those who expect to emerge as winners, so it is preferred by nations that possess actual or perceived competitiveness. There is undoubtedly an element of truth in this, as witnessed by the reluctance of many latecomers to forgo the use of protection for their industrialization in the nineteenth and twentieth centuries. It is plausible, therefore, that the United States' embrace of postwar trade liberalization, even if actuated by the aforementioned considerations of sectional interests and national interest, was reinforced by the essential confidence in the country's likelihood of surviving—and, hence, its national interest in—the Darwinian struggle that freer trade entails.[21]

But the United States' interest in liberal trade appears to have gone beyond all this. Indeed, the executive branch of the U.S. government came to believe that the country's security interests were best served by the pursuit of liberal trade

21. The role of this Darwinian factor in the nineteenth-century experience with (unilateral) British trade liberalization, the U.S.-led postwar trade liberalization, and the current debate on U.S. trade policy is explored further in Bhagwati and Irwin 1987.

policies. On this view (most forcefully argued in recent years by the political scientist Douglas Nelson [1987]), the United States' embrace of trade liberalization was motivated not by cerebral faith in the economic virtues of free trade but by expectations that the domestic political costs of liberalization would be offset by security gains in the realm of foreign policy. Citing the triumph in the Truman Administration of the "Cold War realists," such as George Kennan, whose strategic vision emphasized the use of economic instruments to contain the Communist threat, Nelson argues[22] that

> *The instruments of international economic policy (including trade policy) were seen as fundamental instruments of national security policy. The first task to which these instruments were turned was the reconstruction of a Europe seen as poised on the brink of economic collapse, with local Moscow-oriented communist parties waiting in the wings. The Marshall Plan transferred needed financial resources directly, and liberalization of the U.S. trade regime (with broad exemptions for Europe) was expected to transfer resources indirectly. (1987, p. 15)*

The belief that other nations' gains from trade would promote American security is not inconsistent with the ideological position that trade is beneficial. But this particular thesis implied a belief in the related liberal proposition that "all good things go together"[23] and reinforced in a major (per-

22. Nelson goes so far as to deny, implausibly, that direct economic gains from trade liberalization were of any consequence in U.S. policymaking, arguing that in fact these policy makers thought of trade liberalization as involving economic costs to the U.S.: "The major policy-makers in the Truman White House and State Department (Secretaries of State Marshall and Acheson in particular) not only did not perceive trade as economically advantageous but, to the extent that they considered its economic effects at all, tended to see it primarily in terms of costs." (1987, note 16)

23. See Packenham (1973) on this strand in U.S. liberal thinking in the postwar period. It is manifest in frequent assertions that population control is good not merely in itself but because it will promote peace, and that

haps decisive) way the United States' postwar commitment to a liberal trading order.

Institutions

This commitment explains the United States' support for the General Agreement on Tariffs and Trade—which, notwithstanding all its warts, was the institution that oversaw and sustained the postwar liberalization.

Although GATT was a contractarian arrangement, the United States looked the other way when it came to requiring GATT members to fulfill symmetric obligations. In the political interest of building a stronger Europe, for example, the United States allowed asymmetrical access to markets during the long period when Europe was shifting to convertibility in current-account transactions. And the United States acquiesced in the enactment of Part IV and the granting of other special and differential treatment to developing countries, which gave them a handicap and hence an exemption from the symmetric GATT obligations which their underdeveloped status seemed to justify, much along the lines of "affirmative action" in domestic programs.

One can view the postwar period from either of two stylized perspectives. Either one can argue, with Kindleberger (1981), that the United States played a leadership role in supplying the "public good" of a GATT regime oriented toward freer trade while letting "free riders" (such as Europe in the early years of GATT, and the developing countries) escape the burden of accepting symmetric market-access obligations, or one can draw the inference that the United States

foreign aid will create prosperity and thus arrest the spread of Communism. These claims are not just ways of "selling" programs; they often reflect genuine convictions.

was acting as the leader in the sense of sustaining GATT by permitting justifiable asymmetries of obligations for these nations on a temporary basis. The latter interpretation seems more consonant with the events. It also suggests that, as these temporary circumstances ended, with the recovery of Europe and the dramatic growth of the more advanced of the newly industrialized countries, the United States would return to its original contractarian conception of GATT and begin to look for reciprocity of market access (as indeed it does today).

GATT provided the mechanism and the momentum that the ideology and the interests favoring freer trade needed in order to influence policy. Institutions create opportunities for interests, even spawning them; in turn, they are shaped by them. GATT, with its commitment to the process of freer trade and the goal of substantial free trade, provided the protrade forces—especially the executive branch of the U.S. government—with a vehicle for initiating and sustaining successive and successful efforts at reducing tariffs (recall figure 1). The many GATT rounds, aimed at slashing tariffs, proved effective in dealing with the ever-present protectionist pressures from constituency-conscious congressmen; they served to counter these pressures on the grounds that succumbing to them would imperil ongoing deliberations and negotiations. An ongoing, continual set of rounds was thus tactically wise as well. Washington wits have christened this the "bicycle theory": unless you keep pedaling, you will fall off.

Yet another fundamental institutional change—this one within the United States—reinforced the liberalization process and the political opposition to protection. The Smoot-Hawley fiasco had led to a transfer of tariff-setting authority from the Congress to the executive branch, which had a protrade bias. In itself this move imparted a powerful antiprotectionist thrust to U.S. policymaking; however, it also reinforced the pro-trade position in a subtler way. Previously, congressmen had been susceptible to direct constituency pressure, and made-to-order tariffs had emerged under Smoot-Hawley in a process of log-rolling that reflected "reciprocal noninterference" among the legislators. This stopped when the setting of individual tariffs was shifted away from the Congress. Instead, protectionist pressures now had to be concentrated on protectionist *rules*. Now narrow questions concerning the favorite tariffs of individual legislators gave way to broader questions of protectionism versus free trade. Reciprocal noninterference was replaced by lobbying, which was somewhat less unevenly divided between the protectionists and the pro-traders. For any level of protectionist pressure, the supply of protection should then fall.[24]

In the end, then, the postwar liberalization of trade can be attributed to a richly textured interplay of interests, ideology, and institutions. But during the 1970s the scene changed conspicuously. There was an onset of protection, and a widespread outbreak of protection was feared. What went wrong?

24. This argument, developed by Nelson (1987), is explored further in Hall and Nelson 1987. On other institutional matters relevant to U.S. trade policy, see Baldwin 1985b.

The Rise of Protectionism

3

The downward trend in trade restrictions resulting from declining tariffs was rudely interrupted in the mid-1970s. An offsetting growth in trade barriers followed. The negotiated tariff reductions were accompanied, and their incremental effect in loosening the restraints on the world trading system was seriously compromised, by the growth of *nontariff barriers* (NTBs). Economists often refer to these barriers as *administered protection*, because they typically do not imply legislative enactment of each act of protection (although, of course, legislative consent—implicit and explicit—is necessary for the exercise of executive and quasi-judicial powers and discretion in the granting of protectionist demands made by specific petitioners and lobbies). These restrictions are customarily applied through institutions and processes set up to regulate imports, including the exercise of political power by the executive branch in making trade-restraining arrangements with other countries.

Two classes of nontariff barriers, with wholly different implications, must be distinguished: those that bypass GATT's rule of law and those that "capture" and pervert it. The former class consists of the "high-track"[1] (that is, visibly